# In the Supreme Court of the United States

OCTOBER TERM, 1975

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No. 75-865

NANCY C. TERRIBERRY, ET AL., PETITIONERS

*v.*

UNITED STATES OF AMERICA

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*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT*

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**MEMORANDUM FOR THE UNITED STATES IN OPPOSITION**

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The question presented in this federal estate tax case is whether the decedent possessed "incidents of ownership" in insurance policies on his life because of his power as co-trustee of a trust to elect certain settlement options under the policies which he transferred to the trust. The decision below held that such power was an "incident of ownership" so that the proceeds of the policies were includable in the decedent's gross estate under Section 2042 of the Internal Revenue Code of 1954.

The pertinent facts are as follows: In the 1940's, the decedent transferred ownership of seven insurance policies on his life to his wife. In 1964, however, in order to avoid the high probate costs prevalent in Florida, the decedent and his wife decided to transfer their respective estates to separate *inter vivos* trusts. Although the decedent and his wife wanted to retain personal control over their estates,

Florida law did not permit them to name themselves as sole trustee of their respective trusts. Accordingly, they each settled upon the plan of naming the other to act as co-trustee (Pet. App. 25, 32-33).

In the revocable *inter vivos* trust created by decedent's wife, she named herself and decedent as co-trustees, named herself income beneficiary and provided for the disposition of the property upon her death to certain beneficiaries. Article III of the trust instrument granted decedent, as trustee, certain powers over insurance policies on his life. In pertinent part, the trust provided that—

> * * * the Grantor and her husband, G. Gilson Terriberry, or either of them, as Trustee(s) may upon surrender or maturity of the insurance contracts elect a settlement option based upon the life of either the Grantor or her said husband, G. Gilson Terriberry; Provided, they or either of them are, at the time of the election of such settlement option, a beneficiary of the trust.

(Pet. App. 27-28, 34-36; R. 53-67).[1]

In 1968, the decedent died survived by his wife. At the time of his death, the decedent still held the position of co-trustee of his wife's trust and that trust still owned the insurance policies on decedent's life (Pet. App. 28, 36). On audit, the Commissioner of Internal Revenue determined that the date-of-death value of the policies was includable in his estate because the decedent's powers to elect the settlement options on the policies constituted "incidents of ownership" within the meaning of Section 2042 of the Code.

In this refund suit brought by petitioner, decedent's executor, the district court rejected the Commissioner's

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[1] "R." refers to the record appendix in the court of appeals.

position. It held (Pet. App. 32-42) that the decedent's power as co-trustee did not constitute an "incident of ownership." The court of appeals reversed, with one judge dissenting (Pet. App. 23-42). It concluded that the decedent's powers under the trust instrument to elect the policies' settlement options and thereby determine the "time or manner of enjoyment" of the policies was an "incident of ownership" under Section 2042 which decedent possessed at the time of his death. Accordingly, it held the proceeds of the policies were includable in decedent's gross estate.

1. Section 2042(2) of the Code provides if a decedent "possessed at his death any of the incidents of ownership" of insurance policies upon his life, the value of the proceeds of those policies is includable in his gross estate. The statute does not enumerate the various types of "incidents of ownership" that could pertain to an insurance policy. As the congressional committees noted when considering the predecessor to Section 2042, "it is impossible to include an exhaustive list." H.R. Rep. No. 2333, 77th Cong., 2d Sess., p. 163 (1942); S. Rep. No. 1631, 77th Cong., 2d Sess., p. 235 (1942). However, the committee reports provided the following "nonexhaustive" list of powers encompassed within the term "incidents of ownership" (*ibid.*):

> Examples of such incidents are the right of the insured or his estate to the economic benefits of the insurance, the power to change the beneficiary, the power to surrender or cancel the policy, the power to assign it, the power to revoke an assignment, the power to pledge the policy for a loan, or the power to obtain from the insurer a loan against the surrender value of the policy. Incidents of ownership are not confined to those possessed by the decedent in a technical legal sense. For example, a power to change the beneficiary reserved to a corporation of which the decedent is sole stockholder is an incident of ownership in the decedent.

Thus, the focus of congressional concern was upon all powers which would affect the disposition of the proceeds of the policy.

The long-standing Treasury Regulations promulgated under Section 2042 implement this congressional intent. These Regulations (Treasury Regulations on Estate Tax (1954 Code), § 20.2042-1(c) (4) ) provide —

> A decedent is considered to have an "incident of ownership" in an insurance policy on his life held in trust if, under the terms of the policy, *the decedent (either alone or in conjunction with another person or persons) has the power (as trustee or otherwise) to change* the beneficial ownership in the policy or its proceeds, or *the time or manner of enjoyment thereof,* even though the decedent has no beneficial interest in the trust. * * * [emphasis supplied].

In view of the intention of Congress to encompass the entire range of powers over the disposition of the proceeds of insurance policies, the decision below correctly concluded that the decedent's powers over the policies on his life were "incidents of ownership" within the meaning of Section 2042. Here, under the trust, the decedent had the power to grant immediate, rather than deferred, enjoyment of the policies and thus vitally to affect the "time or manner of enjoyment" of the insurance within the meaning of the Regulations. *In re Estate of Lumpkin,* 474 F.2d 1092 (C.A. 5). *Contra: Estate of Connelly* v. *United States,* 398 F. Supp. 815 (D. N.J.), appeal pending, C.A. 3, No. 76-1149. As this Court has noted in an analogous context, the power to control the time of enjoyment of property "is a significant power," *United States* v. *O'Malley,* 383 U.S. 627, 631. See also *Lober* v. *United States,* 346 U.S. 335. Since the decedent's power to elect the settlement options could affect the time for disposition of the proceeds of the policies, the decision below correctly held that such a power was an "incident of ownership" within the meaning of Section 2042.

Contrary to petitioners' argument (Pet. 15-20) and the dissent in the court below (Pet. App. 31), there is no justification for disregarding the decedent's power over the policies on the ground that his wife's trust was revocable. Section 2042 requires that those policies over which decedent "possessed at his death any of the incidents of ownership" be included in his estate without regard to whether those powers are revocable. Here, the decedent fully "possessed" the powers "at his death" because his wife had never exercised her power to remove him or to revoke the trust. Cf. *W. & W. Fertilizer Corp.* v. *United States*, Ct. Cl., No. 17-74, decided December 17, 1975. Moreover, the decedent's authority over the policies was not fettered by any obligations imposed by his fiduciary status. His wife explicitly granted him full discretionary authority over the matters she ceded to his control.

Accordingly, there is no practical basis for distinguishing the decedent's powers as co-trustee from similar powers held in an individual capacity. Since the decedent's powers were freely and fully exercisable by him at the date of his death, he "possessed" them within the meaning of Section 2042. *Rose* v. *United States*, 511 F.2d 259 (C.A. 5); see H.R. Rep. No. 2333, *supra*, at p. 163.

2. Petitioner contends (Pet. 7-12) that the decision below conflicts with either *Estate of Fruehauf* v. *Commissioner*, 427 F.2d 80 (C.A. 6), or *Estate of Skifter* v. *Commissioner*, 468 F.2d 699 (C.A. 2). In *Fruehauf*, the decedent's wife applied for, paid for and owned insurance policies on the decedent's life. Upon her death, she left the policies to a trust, in which the decedent was the income beneficiary. The decedent was one of the trustees of the trust which specifically authorized the trustees to sell the policies or surrender them for their cash surrender value. The Sixth Circuit agreed with the Commissioner's determination that the decedent's powers over the policies constituted "incidents of ownership" under Section 2042. The

decedent had the authority to exercise his power as trustee for his individual economic benefit by converting the nonproductive policies into income-producing properties and thus increasing the value of his own income interest. Because of this possibility of economic benefit, the Sixth Circuit concluded that the decedent's fiduciary powers were "incidents of ownership." In dictum the court stated (427 F.2d at 85) that not every power held by a decedent in a fiduciary capacity would come within the statutory term "incidents of ownership."

As in *Fruehauf*, the decedent in this case had the power to change the nonproductive life insurance policies into assets generating current income from which he might have benefitted personally because he was a contingent income beneficiary under the trust. Although the possibility for personal enrichment here may have been less direct than in *Fruehauf*, the potential for such economic benefit was nonetheless present. While we submit that the decision below correctly held that includability of a life insurance policy should not turn on whether the decedent can direct the benefits of insurance to his own economic benefit, the possibility of economic benefit in this case was sufficient to classify the decedent's powers as "incidents of ownership" even under the *Fruehauf* rationale.

The possibility that the decedent might receive economic benefit as a result of his exercise of his powers over the policies similarly distinguishes this case from *Estate of Skifter* v. *Commissioner*, *supra*. There, the decedent had transferred to his wife all of his interest in nine insurance policies on his life. Upon his wife's death, she left the policies to a trust of which the decedent was trustee. As trustee, the decedent was given the power to distribute the policies to the income beneficiary and the power to sell or surrender the policies and reinvest the proceeds.

After observing that it was "significant" that there was "no way in which [the decedent] could have exercised his powers to derive for himself any economic benefit from [the] insurance policies" (468 F.2d at 702), the court concluded that the decedent's powers as trustee were not "incidents of ownership" under Section 2042. Unlike the situation in *Skifter*, the decedent here, as we have pointed out, was a contingent beneficiary of the trust holding the insurance policies. Thus, the exercise of his powers to employ the settlement options under the policies might have resulted in his receipt of economic benefit.

After analyzing the case in terms of the "significant" fact that the decedent could not have benefitted from the exercise of his fiduciary powers, the Second Circuit in *Skifter* expressed the view (468 F.2d at 702) that Congress intended Section 2042 "to parallel the statutory scheme governing the interests and powers that will cause other types of property to be included in a decedent's estate" under Section 2036 (transfers with retained life estate), Section 2037 (transfers taking effect at death), Section 2038 (revocable transfers), and Section 2041 (powers of appointment). Because the decedent's fiduciary powers would not have triggered inclusion of the other trust assets in the decedent's estate, the court reasoned that Section 2042 should not be construed to reach the insurance policies.

As we have stated, we believe that the decision below correctly interpreted Section 2042 as an independent provision which does not turn on the possibility of economic benefit to the decedent as a result of the exercise of his powers. However, in concluding that none of the more general estate tax provisions was applicable,[2] the Second

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[2] In so concluding, the Second Circuit interpreted Section 2038 quite narrowly. That provision requires that property which a decedent has transferred before his death be included in his taxable estate if, at the date of his death, enjoyment of the property was subject to change

Circuit in *Skifter* acknowledged that "[i]f the power had been exercisable for the benefit of decedent, or for the benefit of whomever the decedent selected, it would have been necessary to include the [insurance] proceeds in the estate; for there would [have been] a powerful argument that this was an incident of ownership since he would have had the equivalent of a [Section 2041] power of appointment * * *" (468 F.2d at 703). In light of the foregoing statement, the possibility of economic benefit to the decedent here makes it likely that the Second Circuit would have held that the insurance proceeds in this case were part of the gross estate under Section 2042. There is accordingly no conflict of decisions "on the same matter" within Rule 19(1)(b) of the Rules of this Court.

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
*Solicitor General.*

FEBRUARY 1976.

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by reason of the decedent's exercise of a power to alter, amend, revoke or terminate. In *White* v. *Poor*, 296 U.S. 98, this Court held that this statute did not attach to property over which the decedent had acquired such a power through the action of unrelated persons, rather than through a reservation of authority attached to the gift. However, in Section 805 of the Revenue Act of 1936, 48 Stat. 1744-1745, Congress amended the provision so that it explicitly covered all powers, "without regard to when or from what source the decedent acquired such power." Despite the terms of the statute, the court in *Skifter* viewed the amendment as applying only to the exact situation at issue in *White* v. *Poor*, in which a power the decedent had originally created thereafter came under her control in exactly the terms in which she had originally created it.